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BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of

THE APPLICATION REGARDING
THE CONVERSION AND
ACQUISITION OF CONTROL OF
PREMERA BLUE CROSS AND
ITS AFFILIATES

No. G02-45

PRE-FILED DIRECT TESTIMONY
OF LICHIOU LEE

I, Lichiou Lee, do hereby declare that the following facts are personally known to me and, if called upon to do so, I would testify to them.

1. I am now, and at all times pertinent herein was, over the age of eighteen (18) years, and competent to testify in a court of law.

2. The Washington State Office of Insurance Commissioner (OIC) employs me as an Actuary, Insurance Policy and Rate Regulation. I have been employed by the OIC since 1995, and have been in my current position since September 2002. I have also been the lead health actuary of the OIC since October 1999. In that capacity, I am responsible for reviewing under applicable Washington law the rate filings of health care service contractors doing business in this state including those filed by Premera Blue Cross.

3. I am an associate of the Society of Actuaries (ASA), and a member of the American Academy of Actuaries (MAAA). I meet the continuing education

1 requirement of the MAAA. I am also a qualified actuary as defined by WAC 284-05-
2 060.

3 4. I have eight years experience in the health-related actuarial field. My
4 experience with the OIC includes performing statistical and actuarial analyses of rating
5 plans and reports of insurance experience applicable to specific regulatory issues,
6 providing information regarding actuarial matters and interpretations of departmental
7 regulations to governmental agencies, insurance companies, the legislature, and the
8 public, and assisting in the drafting and review of legislation and departmental
9 regulations and in development and implementation of regulations. A description of my
10 education and other professional experience are stated in my resume attached as Exhibit
11 "S-36" and incorporated herein by reference.

12 5. During the past eight years, I have reviewed the health care service
13 contractor and health maintenance organization plan rate filings, particular the small
14 group rate filings. I believe it would be useful to provide a history of how carriers are
15 allowed to apply certain actuarial principles of the small group and individual rate
16 filings and still meet the requirements of adjusted community rates under RCW
17 48.44.022 and 48.44.023.

18 6. RCW 48.44.023 was enacted in 1995 under ESHB1046. Subsection
19 (3)(a) requires carriers to develop small group rates based on adjusted community rates,
20 and carriers may vary the adjusted community rates by only four factors: geographic
21 area, family size, age and wellness activities. Subsection (3)(i) requires that adjusted
22 community rates pool the medical experience of all groups purchasing coverage.
23 Subsection (3)(g) states that rating factors shall produce premiums for identical groups
24 that differ only by the amounts attributable to plan design, with the exception of

1 discounts for health improvement programs. The definition of “adjusted community
2 rate” in RCW 48.43.005(1) states that adjusted community rate means the rating
3 method used to establish the premium for health plans adjusted to reflect actuarially
4 demonstrated differences in utilization or cost attributable to geographic region, age,
5 family size, and use of wellness activities. Under RCW 48.44.023, the rates for small
6 groups may vary only by plan design, geographic area, family size, age and wellness
7 activities.

8 7. The statutory definition of adjusted community rates does not prescribe
9 any methodology for developing the four allowable factors nor does it require carriers
10 to use all four factors for the small group rates. Therefore, carriers have the ability to
11 choose to use from zero to four factors to fit within their marketing strategy. However,
12 before and after applying any factors, the projected premiums must be revenue neutral;
13 that is, under current demographic assumptions, carriers do not gain or lose the overall
14 projected revenues before or after they apply the factors.

15 8. Because RCW 48.44.023(3)(i) requires carriers to pool all small group
16 experience, the OIC has been interpreting this to mean that the pooling requirement
17 applies to every aspect of the rate (and rate change) filing, including developing the
18 four allowable factors. For example, a carrier should not segregate the small group plan
19 claim experience in one particular area and use solely that claim experience to develop
20 that area factor for the small group rates. If the carrier segregates the small group
21 experience to develop rates or factors, it’s not pooling anymore. Furthermore, by
22 separating the small group experience to develop plan rates or factors, the carrier could
23 produce a wide range of rates based on segments of the small group experience, which
24 would also defeat the purpose of pooling.

1 9. Since 1996, the OIC has been communicating with carriers through
2 Technical Assistance Advisories or meetings on the rating of small groups. Because
3 there have been numerous questions from carriers about the adjusted community rated
4 statutes, the OIC sent out a Technical Assistance Advisory in 2000 to answer the
5 questions. In general, this office allows the actuarial methodologies or principles to be
6 used as long as they are not in violation of the adjusted community rates, especially the
7 pooling requirement.

8 10. To elaborate more, the following are illustrative examples. Suppose
9 carrier XYZ has two small group plans "A" and "B" and the provider reimbursement
10 schedules of plan "A" increase an average of 5%, the OIC would allow this 5% increase
11 on top of the general overall pool increase since, in general, provider reimbursement
12 schedules develop from negotiations between the carriers and the providers and are not
13 based upon the claims experience of Plan "A." Another example is the development of
14 area factors. If the carrier develops the area factors through company-wide claim
15 experience or through a consultant's large study, the OIC would allow the area factors
16 since the factors do not strictly tie in to the areas' claims experience of the small group
17 pool.

18 11. The main idea of pooling the small group experience is to cross-subsidize
19 between plans. Therefore, one can argue that when the legislature set the pooling
20 requirement, it already took away the expectation of actuarial justification for each
21 small group plan. By allowing carriers to choose and set the allowable factors, it also
22 gives carriers the flexibility to decide how they want to cross-subsidize subscribers
23 among area, age, family size and wellness activities.

1 12. For the individual rate filings, the adjusted community rated requirements
2 under RCW 48.44.022 mirror those of small group rate filings with one additional
3 allowable factor, tenure discounts. However, rates for individual contracts are filed for
4 informational purposes only, RCW 48.44.017(2), and the OIC may request only certain
5 supporting documentation as provided by RCW 48.44.017(3) and may not disapprove
6 or otherwise impede the implementation of the filed rates as mandated by RCW
7 48.44.017(4).

8 13. RCW 48.44.017 was enacted in 2000 and may be found in Chapter 79,
9 Laws of 2000 (E2SSB 6067). The statute establishes many new requirements for the
10 individual line of business. The requirements set forth in RCW 48.44.017 apply to all
11 existing individual health plans within the carrier's individual line of business and do
12 not distinguish between new and existing individual plans. Because the OIC has
13 limited authority to request information related to rate filings for individual products
14 and rates are filed for informational purposes only, the rate filing requirements stated in
15 WAC 284-43-915, WAC 284-43-930, and WAC 284-43-945 no longer apply to the
16 individual line of business.

17 14. Premera Blue Cross is licensed as a health care service contractor, and is
18 subject to the requirements of chapters 48.43 and 48.44, RCW. I am informed that
19 Premera is currently offering new individual products created in 2000 and renewing the
20 individual products created before 2000. LifeWise Health Plan of Washington, a
21 subsidiary of Premera, currently also offers individual plans. For the most recent
22 individual rate filing filed with the OIC effective June 1, 2003, Premera did not apply
23 any area factors on the individual plans. For the small group rate filing filed with the
24 OIC effective June 1, 2003, Premera utilized area factors. The rate filing used 7 regions

1 and 9 network delivery types. For each network delivery type, the rates are different
2 for each region. According to Premera, the area factors are derived based on its cost
3 model, mainly due to the difference of provider reimbursement schedules. According
4 to the small group rate filing effective June 1, 2003, the provider reimbursement rates in
5 Eastern Washington, in general, are lower than those of Western Washington for the
6 same network delivery type.

7 15. In my opinion, there are ways that Premera may be able to increase its
8 competitiveness in certain regions by setting the area factors. One simple example is to
9 remove the area factors for the small group plans; that is, to not apply any area factors,
10 the same as its current individual plans. This means that the costs to provide the health
11 care are spread out among Washington State small group policyholders; that is, the
12 Eastern Washington policyholders subsidize the Western Washington policyholders if
13 the utilizations in Eastern Washington and Western Washington are the same. To
14 elaborate more, the following is an illustrative example. Assume that the monthly
15 premiums in Eastern and Western Washington are \$180 and \$200 Per Member Per
16 Month (PMPM) respectively due to the implementation of area factors, and the monthly
17 premium is \$190 PMPM throughout Washington State if no area factors are applied. In
18 this illustrative case, for the policyholders in Eastern Washington, the monthly
19 premium is increased. For the policyholders in Western Washington, the monthly
20 premium is decreased.

21 16. Another example relates to changes to provider reimbursement schedules.
22 When carriers file a rate change filing, they are not required to update the factors.
23 Carriers have the ability to continue using the existing factors or choose to change the
24 factors. When the factors are based on its provider reimbursement schedules, the OIC

1 usually does not question the detailed development of the area factors simply because
2 the provider reimbursement schedules are strictly proprietary information and are not
3 required to be filed with the OIC. If Premera decreases the provider reimbursement
4 schedules in certain regions and choose not to change or update the area factors,
5 Premera may be able to increase the operating margin in those regions.

6 I declare under penalty of perjury under the laws of the State of Washington
7 that the foregoing is true and correct.

8 Dated March 29, 2004 at Tumwater, Washington.

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12 LICHIOU LEE
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